

SPENDING AFFORDABILITY REPORT

Fiscal Year 2004

BALTIMORE COUNTY,
MARYLAND

Spending Affordability Committee
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February 14, 2003

Honorable Members of the Baltimore County Council
Honorable James T. Smith, Jr., County Executive

I am pleased to submit the report of the Spending Affordability Committee, reflecting the Committee's fiscal policy recommendations for fiscal year 2004.

For fiscal year 2004, the Committee establishes a spending affordability guideline of \$1,208,837,324, based on a personal income growth forecast of 4.32%. The Committee also recommends that debt service not exceed nine percent (or \$110,430,000) of FY 2004 General Fund revenues and that total outstanding debt not exceed two percent (or \$908,051,540) of FY 2004 estimated assessed real property value.

It is important to emphasize that the spending and debt affordability guidelines represent neither a ceiling nor a floor on County government spending or debt issuances. The County Executive and County Council may exceed the guidelines if a rationale for doing so is provided. The guidelines are meant to limit spending such that it is affordable and yet, at the same time, provides essential government services and maintains the County's infrastructure at an acceptable level of service.

In determining its guidelines, the Committee reviewed current and projected conditions of the national, state, and local economies. Many economic uncertainties currently exist, including the lingering effects of the recession that began in March 2001. At the same time, various economic indicators suggest that the state and local economies have been performing more strongly than the national economy. Committee members agreed that the County's economy, and the personal income of its residents, will continue to grow in FY 2004.

I would like to thank my Council colleagues on the Committee for their thoughtful participation in the committee process. I also thank Mr. John F. Gaburick, whose thoughtful insights have been invaluable during the Committee's deliberations; Mr. John Hopkins, who helped Committee members understand and interpret much of the economic data presented to the Committee; and RESI Research and Consulting of Towson University, which supplied the Committee with its personal income forecast and other valuable economic analysis. Furthermore, the newly established Baltimore County Economic Advisory Committee assisted the decision-making process by providing real-time views and observations about the state of the local economy.

Finally, I would also like to acknowledge the support of the County Auditor's Office. A very special thanks to Brian J. Rowe, County Auditor; Elizabeth J. Irwin, Manager of Budget Analysis and Fiscal Research; Paul R. Maihan, Principal Analyst; Denise C. Harb, Staff Analyst; and Michelle F. Ganjon, Legislative Specialist, for their great help and spirit of cooperation.

We hope that this report is given careful consideration in the development and review of the County's operating and capital budgets for fiscal year 2004.

Sincerely,

Joseph Bartenfelder, Chairman
Spending Affordability Committee
Councilman, 5th District

JB:mfg

INTRODUCTION

The Baltimore County Spending Affordability Committee was established in order to limit growth in County government spending to a level that does not exceed growth in the County's economy.

The Spending Affordability Committee submits its report by February 15 of each year in order to provide timely input into the budgeting process.

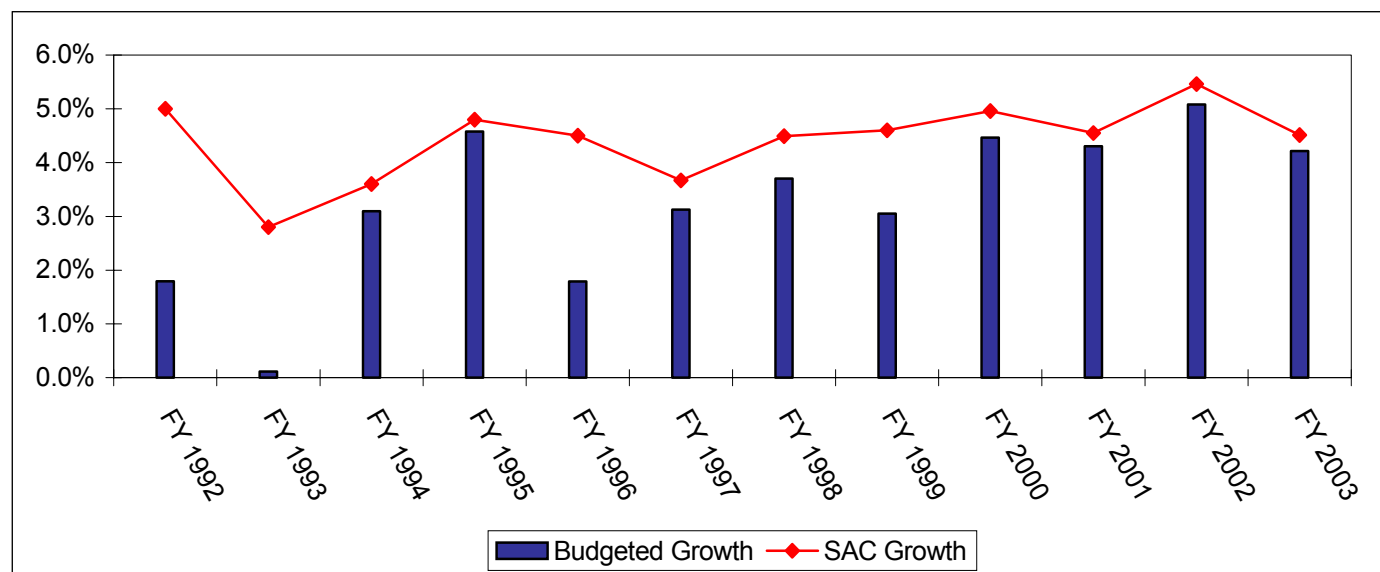
Since the Committee's inception, all County budgets have adhered to spending affordability guidelines.

In March 1990, the Baltimore County Council enacted legislation (Bill 33-90) that established a spending affordability law (Code sections 15-281 to 15-287) for Baltimore County to ensure that growth in County spending does not exceed the rate of growth of the County's economy. The law mandates that the Spending Affordability Committee make a recommendation each fiscal year on a level of County spending that would be consistent with the County's economic growth.

By law, the Spending Affordability Committee must submit a report to the County Council and County Executive by February 15 of each year. This reporting date allows the Executive ample time to consider the Committee's recommendations before formally presenting the proposed budget to the Council on or before April 16 of each year. The purpose of this report is to provide formal input, from the County Council to the County Executive, related to the formulation of the County budget. Such reporting is a significant component of the governmental system of checks and balances, helping to ensure that the operation of County government remains affordable for its citizens.

Committee guidelines are intended to set recommended maximum County spending levels that should not be exceeded in a particular fiscal year; however, they may be exceeded at the discretion of the County Executive and County Council if a rationale is provided for doing so. To date, the County Executive has not proposed and the County Council has not adopted a budget exceeding the Committee's recommended guidelines (Figure 1). The Committee's hope is that the County's fiscal year 2004 operating and capital budgets are again within the Committee's recommended guidelines.

Figure 1. SAC Growth Factors and Budgeted Growth Since Committee Establishment



Sources: FY 1992—FY 2003 SAC Reports; FY 1992 - FY 2003 Adopted Budgets.

ECONOMIC OUTLOOK

The current economic outlook for Maryland and Baltimore County is more positive than the national outlook.

The recession that began in early 2001 was relatively mild, but its effects have lingered, especially on the national employment scene.

State and local labor markets have performed exceptionally well since the onset of the recession.

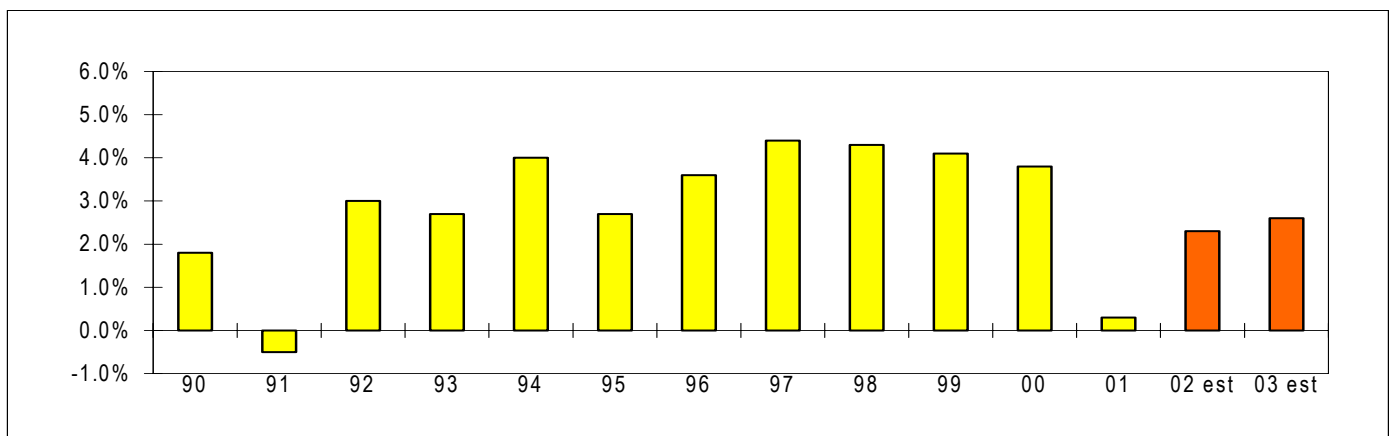
In contrast to national trends, resident employment in Maryland and Baltimore County has increased by 3.7% and 3.8%, respectively.

The Committee reviewed current and projected economic conditions to ensure that its recommendations are consistent with the local economic outlook. This review revealed a mixed picture of national, state, and county conditions including a weaker outlook at the national level than for Maryland or Baltimore County.

The U.S. entered a recession in March 2001 and most observers believe that the economy emerged from that recession after three quarters of decline in real Gross Domestic Product (GDP) from 2001:Q1 to 2001:Q3. The nation's real output contracted by only 0.6% over this period from peak to trough, and for the 2001 calendar year even registered slightly positive growth (Figure 2). The three-quarter decline in output in 2001 was mild compared to declines of the 1990:Q2 – 1991:Q1 and 1974:Q2 – 1975:Q1 recessions, when real GDP fell by 1.5% and 2.9%, respectively. However, while many observers believe that the economy has indeed emerged from recession, the National Bureau of Economic Research (NBER), the official arbiter of dating recessions, has not yet indicated an endpoint to the recession. NBER relies on four economic indicators in dating business cycle turning points: payroll employment, real personal income, industrial production, and real manufacturing/wholesale-retail sales – with the most important indicator being payroll employment. Employment numbers at the national level have been and continue to be weak; however, the state and local labor markets have performed exceptionally well since the recession's onset, especially considering the national experience.

From March 2001 to January 2003, total non-farm employment in the U.S. declined by 1.7 million jobs, or by 1.3%. In contrast, from March 2001 to November 2002, resident employment in Maryland increased by 98,915 persons, or by 3.7%, and in Baltimore County, resident employment increased by 14,348 persons, or by 3.8%. State and local employment

Figure 2. Real Gross Domestic Product: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia, November 2002

In November 2002, the national unemployment rate was 6.0% compared to 3.9% for Maryland and 4.3% for Baltimore County.

The mix of jobs offered in Maryland and Baltimore County has softened the recession's local impact.

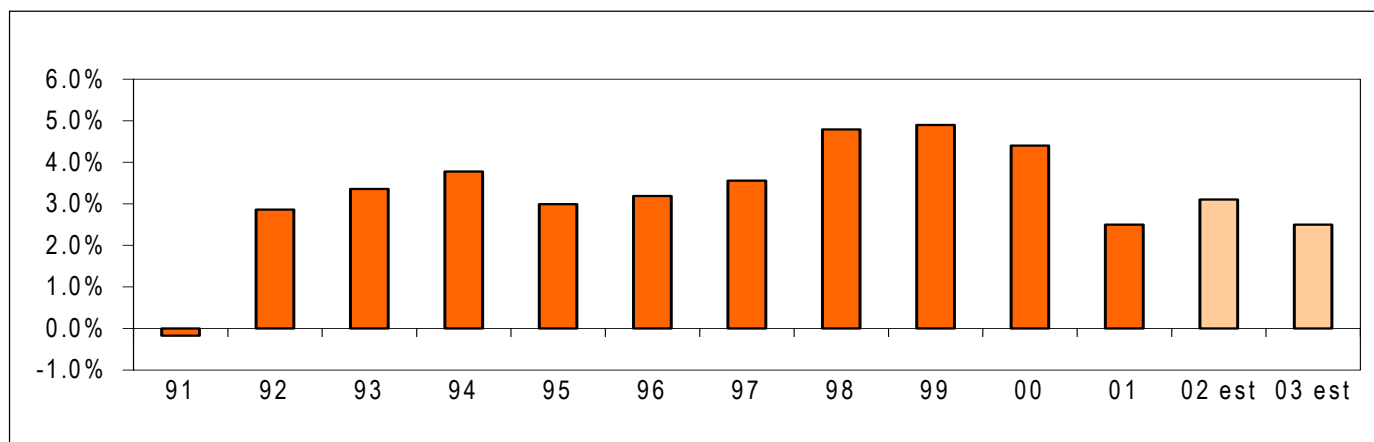
Consumer spending has helped bolster the current economy, thereby thwarting a deeper recession. However, consumer confidence, which is measured nationally, has been declining in recent months.

numbers are at times subject to considerable revisions, but indisputably, the positive employment performance in Maryland and Baltimore County stands in stark contrast to the pronounced downward national trend. In November 2002, the national unemployment rate was 6.0%, while the Maryland and Baltimore County rates stood at 3.9% and 4.3%, respectively. Since March 2001, the national unemployment rate has increased by 1.7 percentage points, from 4.3% to 6.0%, while the unemployment rates for Maryland and Baltimore County have increased by only 0.2 and 0.4 percentage points, respectively.

Maryland and Baltimore County were less vulnerable to the recent economic contraction most likely due to their relatively high proportion of residents who are federal government employees, defense contractors, and health and educational service workers, and their relatively low proportion of residents who hold manufacturing jobs. The recent downturn and subsequent slow recovery has had a significant negative effect on the manufacturing sector. In total, 1.7 million jobs were eliminated nationwide from March 2001 to January 2003, with equal numbers lost in the manufacturing sector alone. The manufacturing sector employs 12.6% of the U.S. labor force, but only provides 6.9% and 8.8% of the jobs in Maryland and Baltimore County, respectively.

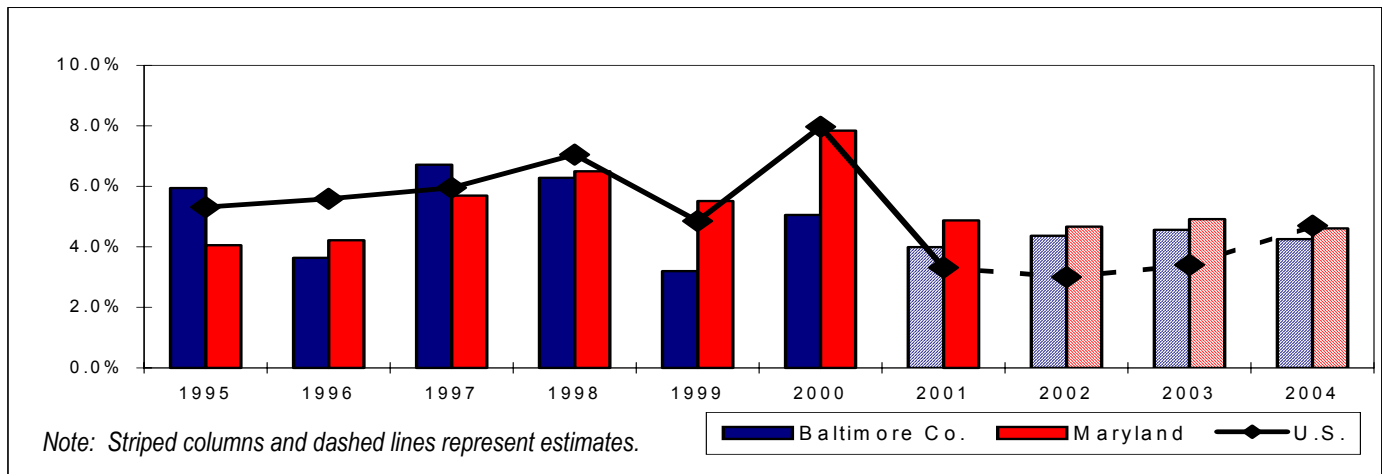
Consumer confidence recently has been declining at the national level, possibly setting the stage for a sharp slowdown or even contraction in consumer spending. Since consumer spending (Figure 3) accounts for two-thirds of GDP, the broadest measure of U.S. economic activity, a fall-off in consumer participation in the economy would likely cause another economic downturn. The weakening consumer confidence picture reflects many concerns, including a higher national unemployment rate that has reached levels not experienced since August 1994, near-weekly announcements of layoffs in corporate America, and geopolitical tensions that create uncertainty and higher oil prices, benefiting energy producers at the expense of energy consumers.

Figure 3. Real Consumer Spending: Annual Percentage Change



Estimate Source: Federal Reserve Bank of Philadelphia, November 2002

Figure 4. National, State, and Local Personal Income Growth



Estimate Sources: RESI, January 2003 (Baltimore County and Maryland); Economy.com, November 2002 (U.S.).

Personal income growth at both the State and County levels is forecast to exceed national personal income growth in FY 2004.

Personal income growth is a gauge of economic growth.

Despite concerns related to slipping consumer confidence and employment, and despite fourth quarter 2002 GDP growth of only 0.7%, in November 2002, Economy.com was forecasting national personal income growth of slightly more than 4% for the fiscal year beginning July 1, 2003, and the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters* was forecasting the nation's real GDP to increase by 2.6% in calendar year 2003. Given the relative strength of the state and local economies, RESI (January 2003) is forecasting that FY 2004 personal income growth will be 4.7% in Maryland and 4.3% in Baltimore County (Figure 4). Other State forecasters are projecting Maryland personal income to grow in the range of 4.0% to 5.4% in FY 2004, with an average forecast of approximately 4.7%. Such personal income growth is a gauge of economic growth.

SPENDING AFFORDABILITY GUIDELINE

The SAC guideline is determined by increasing prior-year base spending by the expected growth in personal income of County residents.

The spending affordability guideline for a given fiscal year is calculated by multiplying the previous fiscal year's estimated "base" spending level (as defined by the Committee) by the Committee's adopted personal income growth factor (Figures 5 and 6). The personal income growth factor, which

Figure 5. Calculation of the Spending Affordability Guideline

The Spending Affordability Guideline for the new fiscal year is calculated by applying a personal income growth factor to the previous year's estimated "base" spending level, as defined by the Committee. Specifically, the recommended level of spending is calculated as follows:

	General Fund Operating Budget Appropriations (previous fiscal year)
+	Supplementary Appropriations
-	Adjustment for spending not subject to the spending affordability guideline (selected non-County funds, General Fund contributions to the capital budget, reserve funds, local grants, and other adjustments itemized in Figure 6)
	<u>Base Spending (previous fiscal year)</u>
	Base Spending (previous fiscal year)
x	Growth Factor (projected personal income growth for the new fiscal year)
	<u>Spending Affordability Guideline (new fiscal year)</u>

Figure 6. Spending Affordability Committee Definition of Base Spending

Base spending: Total General Fund appropriations less appropriations not subject to personal income growth, as itemized below.

Appropriations Not Subject To Personal Income Growth

Appropriations Supported or Determined by Non-County Funds:

- State and Federal Grants Budgeted in the General Fund. These funds are not directly received from County taxpayers and therefore are not dependent upon or controlled by the growth in County personal income.
- Local Share—State and Federal Grants. The total required County General Fund match for all anticipated grants is based on the level (and match provisions) of grant funding. Acceptance of State and Federal grants is discretionary.
- Education—Federal/Restricted Program. The required County General Fund match for such funds in the Department of Education is similarly based on the level (and match provisions) of grant funding.

Capital Budget-Related Appropriations:

- Pay-As-You-Go (PAYGO) Appropriations. The General Fund contribution to the capital budget, if any, is determined annually based on funds that are available and not otherwise committed to supporting County services. Thus, such expenditures may be viewed as one-time outlays.

Appropriations to Certain Reserve Funds and Contingencies:

- Appropriations to the Revenue Stabilization Reserve Account (RSRA). Appropriations or transfers to the RSRA do not represent expenditures but rather a reserve of funds available in case of an operating deficit. These funds are legally required to equal at least 5% of the General Fund budget.
- Contingency Reserve Appropriations. These funds are appropriated for unanticipated needs (e.g., emergencies) and are not earmarked for a specific purpose or program. As such, this appropriation does not represent an expenditure but rather a reserve for contingencies. If these funds were spent, the nature of the expenditure would be examined to determine its effect on base spending (i.e., one-time vs. ongoing).

Local Grants:

- Grants Awarded by the Commission on Arts and Sciences. These grants are purely discretionary and may be viewed as one-time-only. As such, funding is subject to the availability of revenues and/or surplus and need not be limited to growth in personal income.

Other Adjustments:

- Specific exclusions for one-time, nonrecurring costs or revenues such as spending by the Board of Education for items excluded from the State's maintenance of effort requirement.
- Other expenditures or revenues, to be determined on a year-to-year, case-by-case basis.

reflects the estimated percentage growth in County personal income, is based on RESI's most recently published Baltimore County personal income growth forecast.

The Committee approves growth in County spending equivalent to the expected growth in personal income of County residents, as forecast by RESI.

Previously, the Committee had determined its personal income growth factor by first adjusting (from calendar-year to fiscal-year) and averaging several personal income growth forecasts for Maryland. This average State rate was then adjusted to reflect a local growth rate by accounting for the personal income growth differential between Baltimore County and the State as forecast by RESI (the only forecaster providing a separate Baltimore County personal income forecast). This year, noting RESI's past accuracy in its forecasts, the Committee decided to forego its previous multi-step process and instead based its growth factor solely on RESI's Baltimore County forecast. The effect of this policy change on the FY 2004 growth factor is extremely slight (1.0432 using the new methodology versus 1.0435 using the old methodology).

Applying the FY 2004 personal income growth factor of 1.0432 to FY 2003 base spending of \$1,158,778,110 yields a FY 2004 SAC spending guideline of \$1,208,837,324, nearly a \$47 million increase in allowable spending.

Multiplying the FY 2003 base spending level (\$1,158,778,110) by the personal income growth factor (1.0432) results in a spending affordability guideline of \$1,208,837,324 (Figure 7). This guideline represents a \$46.8 million increase over the Administration's FY 2003 spending affordability guideline. **Accordingly, the Committee recommends that the FY 2004 operating budget (as defined by the Committee) not exceed \$1,208,837,324. The Committee further recommends that in staying below this guideline, the Executive avoid intentionally under-funding essential budget areas in order to fund new initiatives.**

Figure 7. FY 2004 Spending Guideline

	FY 2003 Budget
General Fund Operating Budget Appropriations	\$1,199,183,370
Supplemental Appropriations	142,787
Sub-Total	1,199,326,157 (A)
SAC Adjustments:	
Selected Non-County Funds	
State and Federal Grants in Aid (excluding tax reimbursement)	(28,959,152)
Local Share - State & Federal Grants	(4,881,945)
Education - Federal/Restricted Program	(925,000)
Capital-Related Items	
PAYGO	(1,000,000)
Reserve Funds	
Contingency Reserve	(701,455)
Local Grants	
Arts & Science Grants	(3,781,950)
One-time-only Expenditures	(298,545)
Total Adjustments	(40,548,047) (B)
FY 2003 SAC Spending, Base Year (A - B)	\$1,158,778,110 (C)
Growth Factor	x 1.0432 (D)
FY 2004 SAC Spending Guideline (C x D)	\$1,208,837,324

DEBT AFFORDABILITY GUIDELINES

The Committee also adopts two debt affordability guidelines, one pertaining to debt service and the other to total debt outstanding.

The Committee recommends that debt service not exceed nine percent of General Fund revenue.

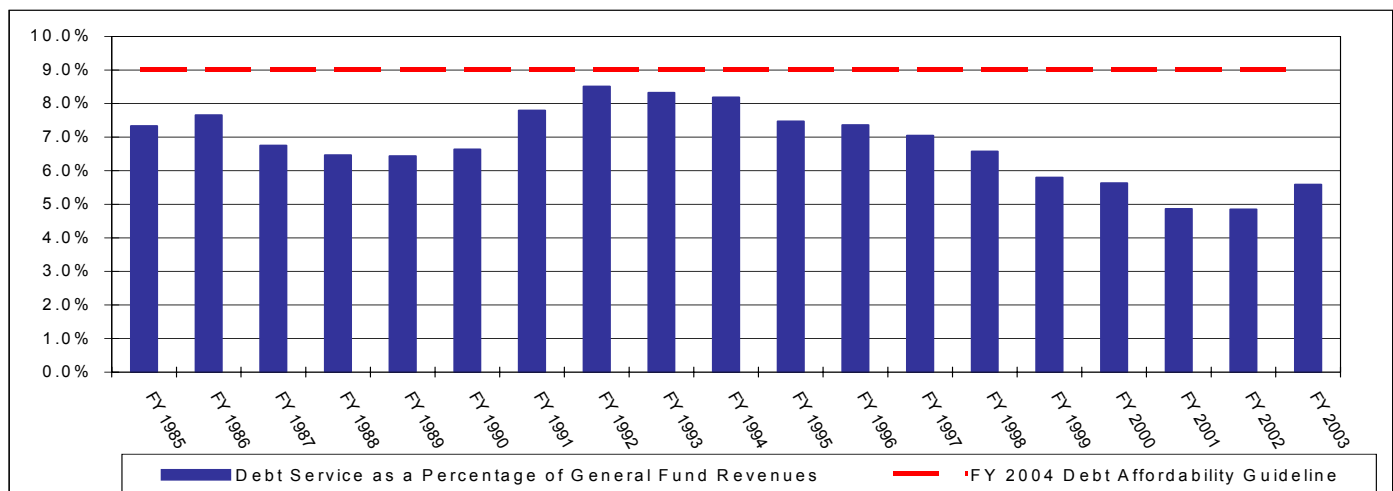
The Committee also recommends that total debt outstanding not exceed two percent of assessed real property value.

In addition to recommending a maximum spending level for the County's operating budget, the Committee adopts two debt affordability guidelines, which are related to the County's capital budget. The Committee's debt affordability recommendations provide an enhanced system of checks and balances, further displaying the County's fiscal responsibility to its citizens, bond rating agencies, and others in the financial community. The debt guidelines are based on: (1) the County's level of debt service as a percentage of General Fund revenue; and (2) the County's total debt outstanding as a percentage of assessed real property value.

The ratio of debt service to General Fund revenue is a debt affordability indicator. Credit analysts generally concur that a ratio higher than 1:10 (i.e., over ten percent) suggests that the debt burden is too heavy. The Administration's financial guidelines historically have set a target range of eight to nine percent; in FY 2003, the amount budgeted for debt service equals 5.6% of anticipated General Fund revenue. This year, the Committee again affirms that debt service should not exceed nine percent of General Fund revenue (Figure 8). **For FY 2004, the Committee recommends that debt service not exceed \$110,430,000, or nine percent of estimated FY 2004 General Fund revenue.**

The ratio of total outstanding debt to assessed property value is a second measure of debt affordability. The County Charter mandates that total County outstanding debt shall not exceed ten percent of the County's assessable base. The Administration's financial guidelines historically have set a target range of 1.4% to 2.0% for debt as a percentage of full (assessed property) value. The Committee believes that a debt guideline should apply only to real property and not to personal property because personal property is not capital in nature and is not typically associated with debt instruments. In FY 2003, total outstanding debt represents approximately 1.5% of full real property value. This year, the Committee

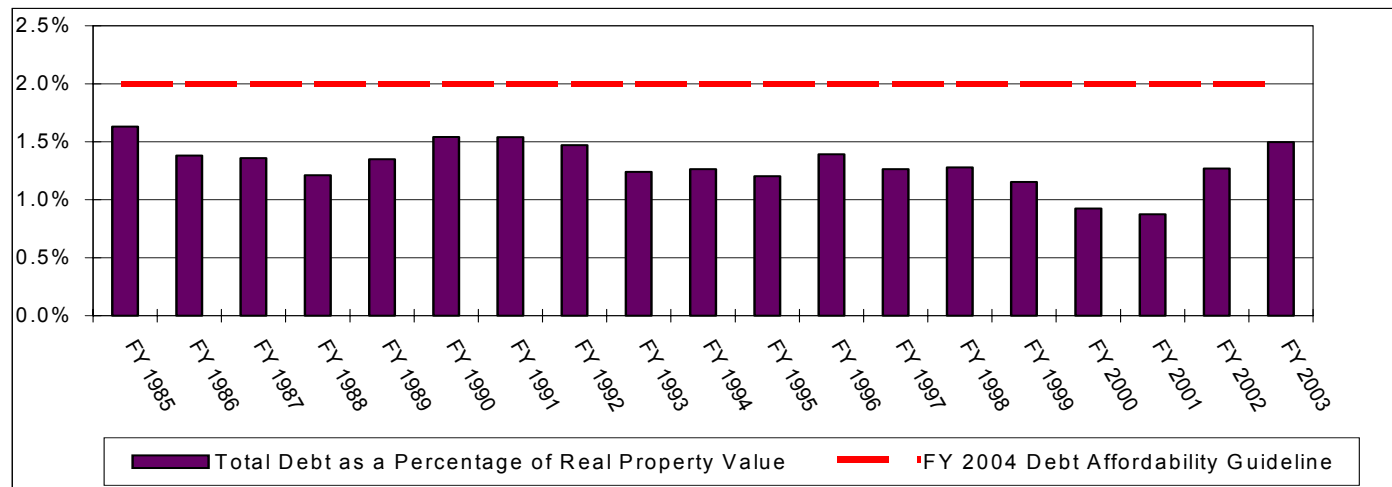
Figure 8. Debt Service as a Percentage of General Fund Revenue



Note: Excludes debt service related to pension funding and metropolitan district bonds; FY 2003 ratio is an estimate.

Source: Baltimore County Annual Budget Documents.

Figure 9. Total Debt as a Percentage of Real Property Value



Note: Excludes debt related to pension funding and metropolitan district bonds; FY 2003 ratio is an estimate.

Sources: Baltimore County Annual Budget Documents; Maryland Department of Assessments and Taxation.

again affirms that total outstanding debt should not exceed two percent of assessed real property value (Figure 9). **Thus, for FY 2004, the Committee recommends that total outstanding debt not exceed \$908,051,540, or two percent of estimated FY 2004 assessed real property value.**

GENERAL FUND REVENUES

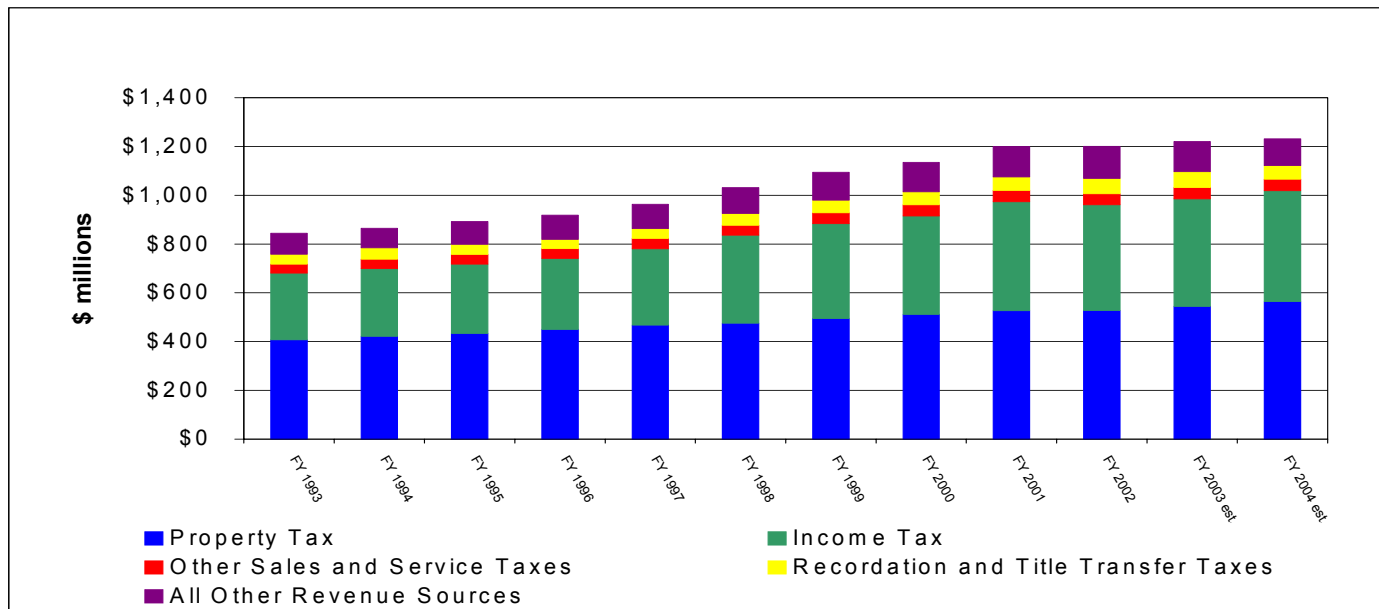
General Fund revenue is expected to grow by only 0.9% in FY 2004, after considering likely cuts in State aid.

FY 2003 General Fund revenue is projected to reach \$1,220.9 million, up \$20.2 million, or 1.7%, from FY 2002 totals, and FY 2004 General Fund revenue is estimated to reach \$1,231.6 million, up \$10.7 million, or 0.9%, from FY 2003 totals (Figures 10 and 11). This relatively slow growth fol-

Figure 10. General Fund Revenue Forecast, FY 2003—FY 2004

Revenue Source	(\$ in Millions)			Percent Change	
	FY 2002	FY 2003	FY 2004	FY 02-03	FY 03-04
	Actual	Revised	Estimate		
Property taxes	\$527.1	\$545.0	\$564.0	3.4%	3.5%
Income taxes	433.8	441.0	455.0	1.7%	3.2%
Recordation & title transfer taxes	62.9	65.0	56.0	3.3%	-13.8%
Other sales & service taxes	45.6	45.9	47.2	0.7%	2.8%
Licenses & permits	3.6	3.7	3.8	2.8%	2.7%
Fines, forfeitures & penalties	6.5	5.5	5.5	-15.4%	0.0%
Service charges	9.6	7.5	7.5	-21.9%	0.0%
Interest on investments	5.3	5.0	5.0	-5.7%	0.0%
Intergovernmental aid	74.8	73.6	73.6	-1.6%	0.0%
Other	31.5	30.0	27.0	-4.8%	-10.0%
TOTAL	\$1,200.7	\$1,222.2	\$1,244.6	1.8%	1.8%
Estimated State Aid Reduction	-----	(1.3)	(13.0)		
Net Total	\$1,200.7	\$1,220.9	\$1,231.6	1.7%	0.9%

Figure 11. Baltimore County Revenues



Source: Baltimore County Annual Budget Documents.

Reductions in State aid to the County will likely occur in both FY 2003 and FY 2004.

lows FY 2002 growth of only 0.1%. Even assuming no reduction in State aid to local governments, General Fund revenue is expected to grow by only 1.8% in each of FYs 2003 and 2004. At no time in recent history (i.e., since FY 1970) has General Fund revenue displayed such a weak 3-year performance.

Even assuming no reduction in State aid to local governments, revenue would be expected to grow by only 1.8% in each of FYs 2003 and 2004.

The FY 2003 estimate reflects stronger-than-expected revenue from property-related transfers due to the surprising continued strength in County real estate transactions, higher than expected “other” revenue, and a 3.4% increase in the County’s largest revenue source, property tax revenue. Additionally, this estimate includes an estimated loss of State aid totaling \$1.3 million. The FY 2004 estimate reflects moderate growth in property and income tax revenues, offset by somewhat lower revenue related to property transfers and by an additional loss in State aid estimated at \$13 million. State aid estimates may change as the General Assembly considers the Governor’s proposed FY 2004 budget.

REVENUE STABILIZATION RESERVE ACCOUNT (RSRA)

The General Fund balance at the end of FY 2003 is expected to total \$121.6 million, including \$66.7 million in the RSRA.

For FY 2003, the General Fund surplus is estimated to total \$121.6 million (Figure 12). This \$121.6 million estimate includes \$66.7 million in the RSRA, which is \$6.7 million more than the minimum required (five percent of the General Fund budget) due to investment income that has accrued to the account since FY 2001. The remaining \$54.9 million represents an undesignated, unreserved surplus.

Figure 12. Estimated General Fund Surplus, FY 2003

(\$ in Millions)		
FY 2002 General Fund Surplus (per Baltimore County Comprehensive Annual Financial Report)		\$ 100.0
FY 2003 Revenue Estimate (per Adopted Budget)	1,200.2	
FY 2003 Revision (per SAC)	<u>20.7</u>	
FY 2003 Revised Revenue Estimate (per SAC)		1,220.9
FY 2003 General Fund Appropriations (per Adopted Budget)	1,199.2	
FY 2003 Supplemental Appropriations	<u>0.1</u>	
FY 2003 Revised General Fund Budget		1,199.3
FY 2003 Estimated General Fund Surplus (per SAC)		\$ 121.6
Revenue Stabilization Reserve Account		\$ 66.7
Undesignated Unreserved Surplus		\$ 54.9

OTHER ISSUES

The Committee will continue to meet in 2003 to discuss ongoing issues related to the affordability of County government spending.

As the Committee continues to review an increasingly broad range of issues, it recognizes the importance of continued meetings after issuance of the annual report. Therefore, the Committee will continue to meet during 2003 to discuss such topics as the use of revenue estimates to limit spending not subject to personal income growth, the statutorily-mandated role of the Committee, the appropriateness of personal income growth as a measure of growth in the local economy, and the growth of County fees for service and other special funds. ■